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Nos. 83-737 and 83-738

In the Supreme Court of the United States

OCTOBER TERM, 1983

PEOPLE OF THE STATE OF CALIFORNIA, ET AL.,
APPELLANTS

v.

UNITED STATES OF AMERICA, ET AL.

NEW YORK STATE DEPARTMENT OF PUBLIC SERVICE,
APPELLANT

v.

UNITED STATES OF AMERICA, ET AL.

ON APPEALS FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

MOTION TO AFFIRM

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QUESTION PRESENTED

Whether the district court abused its discretion in approving, as consistent with the provisions and principles of the modified consent decree, the plan of reorganization agreed to by AT&T and the government, which specifies in greater detail how that consent decree is to be implemented.

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OPINIONS BELOW

The August 11, 1982, opinion of the district court (J.S. App. 1-172) and the modification of final judgment (J.S. App. 173-190) filed August 24, 1982, are officially reported as *United States* v. *AT&T*, 552 F. Supp. 131 aff'd mem. *sub nom. Maryland* v. *United States*, No. 82-952 (Feb. 28, 1983).

The July 8, 1983, opinion of the district court stating that it would approve the plan of reorganization only if

modified in certain respects (J.S. App. 195-330) is reported at 569 F. Supp. 1057-1124. The July 28 and August 5, 1983, memoranda of the district court clarifying and denying reconsideration of the July 8 opinion (J.S. App. 331-340, 341-348) are reported at 569 F. Supp. 1124-1131. The order entered August 5, 1983, approving the plan of reorganization as amended (J.S. App. 349-350) is reported at 569 F. Supp. 1131. The September 7, 1983 order of the district court granting certification to this Court under 15 U.S.C. 29(b) (J.S. App. 351-354) is not yet reported.

JURISDICTION

The order approving the plan of reorganization was entered on August 5, 1983 (J.S. App. 349-350). The notice of appeal of the People of the State of California and the Public Utilities Commission of the State of California was filed on August 10, 1983 (J.S. App. 355-356). On September 7, 1983, the district court certified that the direct consideration by this Court of all appeals in this case is of general public importance in the administration of justice (J.S. App. 351-354). On September 13, 1983, the New York State Department of Public Service filed a notice of appeal (J.S. App. 357-358). The appeals were docketed in this Court on November 2 and 3, 1983. The jurisdiction of this Court is invoked under 15 U.S.C. 29(b).

STATEMENT

1. On January 8, 1982, the government and the American Telephone & Telegraph Company (AT&T) announced the dismissal of the government's pending antitrust case against the company.[1] Concurrently,

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[1] The government sued AT&T in 1974, claiming that AT&T had used its monopoly power in local exchange telephone service to exclude competition in the telecommunications equipment and intercity services markets, in violation of Section 2 of the Sherman Act, 15 U.S.C. 2. *United States* v. *American Tele-*

they announced a proposed modification of a 1956 consent decree entered in an earlier suit[2] which provided all of the relief sought by the government in the 1974 litigation. Specifically, it provided for the separation of the Bell operating companies, which provide local telephone services, from the remainder of the AT&T system. J.S. App. 174-175. This separation would eliminate AT&T's ability to continue the anticompetitive practices alleged in both cases by preventing AT&T from employing monopoly power in local exchange services to disable competition in other, potentially competitive markets.[3] The decree further required that, not

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phone & Telegraph Co., Civ. No. 74-1698 (D.D.C. filed Nov. 20, 1974). In particular, the complaint alleged that AT&T had monopolized customer premises equipment (CPE) by discriminating against competitors' equipment, had monopolized telecommunications equipment used by the Bell operating companies (BOCs) through various preferential devices, and had monopolized intercity telecommunications through discriminatory terms imposed upon and discriminatory refusals to interconnect with other companies. At trial, the government sought the divestiture of those parts of the BOCs that provide local exchange services, or, alternatively, divestiture of Western Electric.

[2] In 1949, the United States sued Western Electric Company, Inc., and its parent, AT&T, claiming that they had monopolized and conspired to restrain trade in the manufacture and distribution of telephone equipment, in violation of Sections 1 and 2 of the Sherman Act, 15 U.S.C. 1 and 2. *United States* v. *Western Electric Co.*, Civ. No. 17-49 (D.N.J. filed Jan. 14, 1949).

[3] The 1956 consent decree prohibited AT&T and the BOCs from engaging "in any business other than the furnishing of common carrier communications services," defined as "services and facilities * * * the charges for which are subject to public regulation under the Communications Act of 1934" or under state law. See J.S. App. 7, 81 n. 196. The decree also required the licensing of Bell System patents to all applicants at reasonable royalties. *Id.* at 7, 77. Because the new structural relief provided by the modified decree renders these restraints unnecessary, the decree frees AT&T from these restrictions. See generally *id.* at 57-58, 66-67.

later than six months after its effective date, AT&T submit to the Department of Justice for its approval a plan of reorganization to implement the decree, such plan to be effective not later than 18 months after the date of the decree. *Id.* at 174.

On August 11, 1982, following extensive comments, briefing and argument by interested parties,[4] the district court issued a lengthy opinion in which it found that most of the provisions of the proposed modified decree, including the basic provision for AT&T's divestiture of the BOCs' local exchange monopolies, were in the public interest (J.S. App. 1-172).[5] The district court stated, however, that it would approve the decree only if the parties agreed to several substantive and procedural amendments to the proposed decree (*id.* at 170-172). Among these was a provision specifying that the plan of reorganization to be prepared by AT&T and approved by the Department of Justice would "not be implemented until approved by the [district c]ourt as being consistent with the provisions and principles of the decree" (*id.* at 156, 172). The government and

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[4] The United States published notice of the proposed settlement and a competitive impact statement in the Federal Register. 47 Fed. Reg. 7170-7184 (1982). The district court received more than 600 comments on the proposed modified decree and numerous briefs on several issues from more than 100 organizations. See J.S. App. 22-25. It also heard oral argument at which 20 counsel from 18 organizations participated (*id.* at 25 & n.65).

[5] Over the objections of several states and state regulatory agencies, the court held that, in order to effectuate the decree's goal of eliminating the effects of past anticompetitive conduct in interstate communications, it could order AT&T to take actions, such as reorganizing and separating assets and common carrier responsibilities, without obtaining prior approval of such actions from state regulatory agencies (J.S. App. 36-48). The court also approved releasing AT&T from most of the line-of-business restrictions and patent licensing requirements imposed by the 1956 decree (*id.* at 77-79).

AT&T thereafter agreed to the court's proposed changes, and on August 24, 1982, the court entered the decree as a modification of the 1956 final judgment in the *Western Electric* case (*id.* at 173-190).[6]

2. The district court allowed numerous states, state regulatory agencies, and private parties to intervene in the proceedings (J.S. App. 191-194), and several of these intervenors noticed appeals from the judgment. On November 10, 1982, the district court, pursuant to the Expediting Act, 15 U.S.C. 29(b), certified the appeals for immediate review by this Court, finding that "immediate consideration of the appeal by the Supreme Court is of general public importance in the administration of justice." See J.S. App. 352-353. As requested by the United States and AT&T, this Court accepted jurisdiction of the appeals and summarily affirmed the decree. *Maryland* v. *United States*, No. 82-952 (Feb. 28, 1983).

3. On December 16, 1982, AT&T submitted a proposed plan of reorganization to the Department of Justice. The Department carefully reviewed the 471-page plan and discussed it with state regulatory officials, other carriers, providers of telecommunications equipment, officials of AT&T and the BOCs, and others. U.S. Resp. at 14-20.[7] As a result of its review, the Department required AT&T to make various modifications and, as modified, the plan was submitted to the district court. J.S. App. 195-196. The court thereafter received comments and briefs filed by intervenors and other interested persons, considered the replies of AT&T and

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[6] Because this decree provided all the relief sought in the 1974 litigation, the court accepted a stipulated dismissal of that case.

[7] "U.S. Resp." refers to the Response of the United States to Public Comments and Action on AT&T's Proposed Plan of Reorganization, filed in the district court on March 24, 1983.

the Department of Justice, and heard oral argument on certain issues. *Id.* at 196-197, 323.

On July 8, 1983, the district court issued a lengthy opinion (J.S. App. 195-330) discussing the proposed plan. The court found that most of the provisions of the plan, including the basic plan for division of assets between AT&T and its subsidiaries and for the eventual provision by the BOCs of equal exchange access for all interexchange carriers, were consistent with the provisions and principles of the decree (*id.* at 197). The district court stated, however, that it would require certain modifications in the plan before approving it (*id.* at 197, 328-330). Following AT&T's and the government's consent to these modifications, the court, on August 5, 1983, entered an order approving the plan as modified (*id.* at 349-350).

4. On August 10, 1983, the People of the State of California and the Public Service Commission of the State of California filed a notice of appeal from the order aproving the plan (J.S. App. 355-356). On August 25, 1983, the United States, supported by AT&T, asked the district court to certify the California appeal and any other appeals for direct review by this Court pursuant to the Expediting Act. No party opposed that request.

On September 7, 1983, the district court certified the appeals, finding that the considerations that had supported direct Supreme Court review of the appeals from the entry of the decree were equally applicable to review of the order approving the plan (J.S. App. 351-354). The court concluded that "[e]ven though it is not likely that the appeals will present questions of legal significance, they are clearly of general public importance" (*id.* at 352) (footnote omitted) because AT&T's divestiture of the BOCs, "apparently the largest corporate reorganization in history, will directly affect millions of employees and shareholders, the na-

tion's telephone subscribers, AT&T's competitors, the telecommunications industry in general, and the responsibilities of federal and state regulatory bodies" (*id.* at 353). Moreover, the district court noted, given the rapidly approaching January 1, 1984, divestiture date, "a speedy, final resolution of the legal situation is all the more necessary" to protect the public interest as well as "the various private interests involved" in the divestiture *(ibid.)*. Accordingly, since "[i]t is unlikely that such a resolution could be secured through the normal process of review by the U.S. Court of Appeals to be followed by a petition for writ of certiorari to the Supreme Court" *(ibid.)*, the district court certified that "immediate consideration * * * of the appeal and of any additional appeals filed hereafter is of general public importance in the administration of justice" (*id.* at 354) (footnote omitted).[8]

ARGUMENT

Last Term, this Court summarily affirmed the modified consent decree entered by the district court in this case. Thus, the Court is familiar with the provisions and principles of the decree and is well aware that its prompt implementation is "of general public importance in the administration of justice" (15 U.S.C. 29(b)). The plan of reorganization, which is the subject of the present appeals, actuates the provisions of the decree, and the policies that justified expedited review last Term are fully applicable here. Moreover, as in the earlier appeal, the issues now before the Court do not warrant

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[8] The New York State Department of Public Service subsequently filed a notice of appeal on September 13, 1983. J.S. App. 357-358. No other party has appealed.

All appeals from the order approving the plan must be taken directly to this Court; the court of appeals has no jurisdiction absent a remand pursuant to 15 U.S.C. 29(b)(2). *United States* v. *Western Electric Co.*, 714 F.2d 178 (D.C. Cir. 1983).

plenary consideration. Accordingly, the United States, pursuant to the Expediting Act, 15 U.S.C. 29(b), and Rule 16.1 of the Rules of this Court, moves for summary affirmance.

I. THE COURT SHOULD ACCEPT THE DIRECT APPEALS

The appropriateness of direct review under the Expediting Act, 15 U.S.C. 29(b), turns on the importance of a prompt decision of a case in view of its economic significance, not on the difficulty or general significance of the legal issues presented. The Act expressly refers to the importance of "immediate consideration of the appeal" and makes no mention of the significance of the issues raised.[9] Similarly, the focus of the legislative history of the Expediting Act[10] is not on the importance of the issues raised to the development of the law, but rather on the immediate economic impact of the case itself.[11] While Congress, of course, did not regard every

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[9] Prior to 1974, the Expediting Act, ch. 544, 32 Stat. 823 *et seq.*, provided for direct review by this Court in all government civil antitrust suits. The Act was amended to its present form in 1974 to relieve this Court of that burden. See S. Rep. 93-298, 93d Cong., 1st Sess. 6 (1973). In amending the statute, however, Congress recognized that occasionally there would be antitrust cases for which the public interest required an avenue of direct appeal to this Court. Accordingly, Congress preserved a limited right of direct appeal under 15 U.S.C. 29(b).

[10] See generally S. Rep. 93-298, 93d Cong., 1st Sess. 7-8 (1973); H.R. Rep. 93-1463, 93d Cong., 2d Sess. 10-11 (1974); 119 Cong. Rec. 24599 (1973); 120 Cong. Rec. 38585-38587, 39123 (1974).

[11] As the House Judiciary Committee noted in its report on this provision, "public antitrust cases are unlike other federal cases, * * * they have an impact on the economic welfare of this nation, and * * * consequently they should be treated accordingly." H.R. Rep. 93-1463, 93d Cong., 2d Sess. 14 (1974). See also S. Rep. 93-298, 93d Cong., 1st Sess. 3-4 (1973); 119 Cong. Rec. 24599 (1973).

government civil antitrust suit as being sufficiently important to merit direct review, it did establish a mechanism by which antitrust cases with the most significant economic impact on the public interest could be appealed directly to this Court. This case satisfies that admittedly high standard.

A. The consent decree in this case provides an effective structural remedy that will further the public interest in competition and remedy past competitive restraints in the vitally important national telecommunications industry. As the district court and this Court recognized, direct review of the decree was necessary to minimize delay in the development of the plan of reorganization and uncertainty as to when—and, indeed, whether—the actions required by the decree would occur. Such delay or uncertainty would have been harmful not only to AT&T, its employees, shareholders, and customers, but also to other firms in the telecommunications and related industries, whose business plans depend on the divestiture schedule. Most importantly, delay would have been harmful to the public interest in speedily ending restraints on competition and establishing a restructured, competitive telecommunications industry.[12] It was for these reasons that the district court certified and this Court accepted expedited consideration of the decree.

B. The plan of reorganization approved by the district court is the essential blueprint for implementation of the decree. Accordingly, the district court correctly concluded (J.S. App. 352) that the same considerations that made expedited review of the decree appropriate are equally applicable to appeals calling into question the validity of the plan; progress toward implementa-

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[12] Expedited direct review of the decree also served to minimize the risk that states would obtain court orders conflicting with or enjoining actions essential to the decree's implementation.

tion of the decree has not lessened the significance of this case. As the district court emphasized in certifying these appeals (*id.* at 353), the plan implements the divestiture mandated by the decree, which is "the largest corporate reorganization in history [and which] will directly affect millions of employees and shareholders, the nation's telephone subscribers, AT&T's competitors, the telecommunications industry in general, and the responsibilities of federal and state regulatory bodies." Since "the various public and private bodies are currently implementing detailed plans to effectuate the reorganization" on the January 1, 1984, date prescribed in the plan, "[u]ncertainty regarding the legal status of [the] reorganization would have serious adverse consequences" for all the diverse interests involved (*ibid.*) (footnote omitted)—adverse consequences that can be avoided by a final ruling by this Court. Such review must be expedited because it is even more clear than it was a year ago that the normal process of appellate review will not permit such a ruling before January 1, 1984, the date of implementation of the plan.[13]

C. Direct review is particularly appropriate in this case in light of the nature of the issues raised by appellants. They have challenged provisions of the plan which, as AT&T explains (Mot. to Aff. 11), have significant financial implications for AT&T, the BOCs, and various regulatory authorities. As a result, the mere pendency of the appeals—despite their lack of merit—creates uncertainty not only for BOC and AT&T managements, but also for the regulators and the millions of investors, potential investors, creditors and ratepayers affected by this case. This Court, having previously re-

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[13] Even if this Court is unable to rule before January 1, 1984, an expedited decision in this Court will better serve the public interest in the prompt resolution of this case than would a remand to the court of appeals, as suggested by appellants (Cal. J.S. 21).

viewed the decree, is familiar with its provisions and principles. Consequently, direct review of the meritless issues raised by California and the New York Department of Public Service should not be unduly burdensome for the Court, particularly when weighed against the public benefit that will result from an expeditious resolution of this exceedingly important case.

II. THE COURT SHOULD SUMMARILY AFFIRM THE JUDGMENT OF THE DISTRICT COURT

The appellants' claims that certain aspects of the plan of reorganization are inconsistent with the modified consent decree are insubstantial and do not warrant plenary consideration.

A. The District Court's Judgment Must Be Affirmed Unless There Has Been A Clear Abuse of Discretion

This Court has affirmed the modified consent decree itself, and appellants cannot and do not challenge the decree's provisions. The government and AT&T, moreover, agree that the plan is consistent with the obligations imposed on AT&T by the decree. Thus, were this a normal case, there would be no need for judicial intervention.[14] But, because of the complexity and importance of this case, the district court insisted that the plan "not be implemented until approved by the [district c]ourt as being consistent with the provisions and principles of the decree" (J.S. App. 152-156, 169-170, 172). The district court has approved the plan, and its determination, contested by appellants, should be given substantial deference by this Court.

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[14] A consent decree has attributes of both a contract and a judicial act (*United States* v. *ITT Continental Baking Co.*, 420 U.S. 223, 236 n.10 (1975)), but it "is to be construed for enforcement purposes basically as a contract" (*id.* at 238). Accord, *United States* v. *Armour & Co.*, 402 U.S. 673 (1971). Like any other contract, a consent decree is properly viewed as an embodiment of the intent of the parties.

The district court found the plan to be consistent with the provisions and principles of the modified consent decree after careful consideration of the extensive submissions by the parties and intervenors.[15] The officials of the newly created regional operating companies, furthermore, represented to the court that the plan (amended as required by the government and the district court) will enable them to be economically and functionally viable, and the vast majority of the intervenors, notwithstanding their diverse interests, now appear willing to accept the plan. Significantly, there is no dispute between the parties to the decree as to its meaning. In these circumstances, deference to the district court's conclusion that the plan is consistent with the decree is peculiarly appropriate and, absent a showing that the district court clearly abused its discretion,[16] the district court's judgment should be affirmed.

B. The Plan's Allocation of Account 232 Assets Is Consistent with the Decree

The central purpose of the modified consent decree is to prevent the recurrence of the anticompetitive conduct alleged in this litigation by separating those parts of the Bell operating companies that provide exchange telecommunications and exchange access services, which presently constitute a series of monopoly markets, from the rest of the Bell System. Thus, the decree

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[15] In the exercise of its oversight function, the district court, which had carefully scrutinized the decree itself, received and considered over 50 sets of comments on the plan from interested persons as well as the responses of the Department of Justice and AT&T, and the statements of officials of the new regional BOCs. See J.S. App. 195-197, 323.

[16] Clear abuse of discretion is the appropriate standard for appellate review of a district court's determination that a consent decree is in the public interest. See, *e.g.*, *Cranston* v. *Hardin*, 504 F.2d 566, 577 (2d Cir. 1974); *City of Detroit* v. *Grinnell Corp.*, 495 F.2d 448, 454-455 (2d Cir. 1974).

provides that the divested BOCs will retain "all facilities, personnel and books of account * * * relating to the exchange telecommunications or exchange access functions" (as defined in the decree) (J.S. App. 174). In addition, the BOCs will receive from AT&T and its affiliates "sufficient facilities, personnel, systems, and rights to technical information" to permit the BOCs to perform those functions independently of AT&T (*ibid.*). AT&T is to retain those "facilities, personnel and books of account * * * relating to other functions (including the provision of interexchange switching and transmission and the provision of customer premises equipment to the public)" (*ibid.*).[17]

Dividing over $150 billion in Bell System assets and corresponding liabilities according to these principles is obviously a complex task. While the government, the district court and most interested persons have concluded that the plan will accomplish this task in a manner consistent with the decree, California and the New York Department of Public Service would each prefer a slightly different allocation of assets. The changes in the plan that each of these appellants advocates would appear to benefit its own local ratepayers over other users of or investors in the national telecommunications system. But that obviously is not a purpose of the decree, and neither appellant can show any abuse of discretion in the district court's approval of the plan.

One category of assets assigned to the BOCs under the plan consists of all assets included in Account 232 of the Federal Communications Commission's Uniform System of Accounts. The Commission defines Account 232 to include "the original cost of installing or connecting items of station apparatus and the original cost of inside wiring and cabling and of drop and block

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[17] The decree allows the BOCs to provide, but not to manufacture, CPE (J.S. App. 183).

wires." 47 C.F.R. 31.232(a). Account 232, in other words, comprises the capitalized cost of connecting telephone equipment on a customer's premises to the local exchange. While appellants agree that some portion of Account 232 should be assigned to the BOCs (see Cal. J.S. 11-13, 15; N.Y. J.S. 5-6), they contend that the "station handling costs" included in this account should instead be assigned to AT&T (Cal. J.S. 11-13; N.Y. J.S. 5-6). California (but not the New York DPS) also contends that "complex intrasystem wiring" should be transferred to AT&T (Cal. J.S. 14-18). Appellants, however, have failed to show that the assignment of the entire Account 232 to the BOCs is inconsistent with the decree.

1. Under FCC accounting procedures, capitalized labor costs associated with the installation and testing of customer premises equipment (CPE), sometimes referred to as "station handling costs," are included as an undifferentiated portion of Account 232. See 47 C.F.R. 31.232. Appellants argue (Cal. J.S. 12; N.Y. J.S. 5) that the plan's assignment of these costs to the BOCs violates the decree's requirement that AT&T retain all "books of account * * * relating to * * * the provision of customer premises equipment to the public" (J.S. App. 174). California also argues (Cal. J.S. 12) that this assignment is inconsistent with the functional separation of assets mandated by the decree because station handling costs relate to CPE, which is an AT&T function under the decree, rather than to the BOCs' exchange functions.

The district court acknowledged (J.S. App. 344) that "a theoretical case could be made" for assignment of station handling costs to AT&T. However, as the court also recognized (*id.* at 344 n.9), the regulatory principles that have governed the recovery of station handling costs have associated them primarily with the growth of the local exchange as a whole rather than

with particular customers. Prior to 1981, it was the Federal Communications Commission's policy to capitalize station handling costs as part of Account 232 and to allow their recovery through rates to all subscribers. The rationale for this regulatory policy was that this method of accounting and recovering the investment in labor costs would make telephone service more affordable and, as a result, increase the value of telephone service for all subscribers by expanding the total subscriber base.[18] When the FCC changed its accounting system to require that station handling costs in the future be expensed rather than capitalized, it provided that embedded investment, which in essence represents a "loan" to all customers to finance the growth of the telephone system, would be recovered over a 10-year period through the rates to those customers.[19] Accordingly, it is consistent with the decree's functional separation provisions and principles to assign accrued station handling costs to the BOCs, which, in accordance with FCC regulatory policy, will be able to continue to recover them from the general body of ratepayers. Since all ratepayers received the benefits associated with the capitalization of these costs, such a result is not, as California contends (Cal. J.S. 13), unfair to "the ratepaying public."

Moreover, as noted by the district court (J.S. App. 344), there is no way to segregate retroactively the time spent connecting CPE from time spent on non-CPE installation work (see AT&T Mot. to Aff. 17). Contrary to California's contention (Cal. J.S. 13), the Department of Justice did not simply accept AT&T's statement on this matter. Rather, the Department investigated in some detail the possibility of segregating

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[18] See *In re AT&T*, 64 F.C.C. 2d 1, 54-55, 354-355 (1977).

[19] *In re Amendment of Part 31, Uniform System of Accounts*, 85 F.C.C. 2d 818, 828-829 (1981).

CPE installation costs and the Department (see U.S. Resp. 91 n.*), as well as the district court (see J.S. App. 344), was persuaded that accurate segregation of these costs is indeed impractical.[20]

The New York DPS's contention (N.Y. J.S. 7) that, by not assigning the accrued station handling costs to AT&T, the plan gives AT&T some unfair advantage in CPE competition also misses the mark. The assignment of station handling costs will not affect AT&T's CPE prices. Those prices will be determined by CPE costs and competitive factors. In a competitive environment, AT&T would not be able to raise CPE prices above CPE costs to recoup past station handling costs (or any other non-CPE cost), since customers would simply buy from AT&T's competitors if it did so. In other words, capitalized past costs are an "asset" to regulated companies only because regulatory policies allow them to be recovered from ratepayers. In a competitive market, these kinds of capitalized installation costs are simply a kind of "bad debt." Thus, if station handling costs were assigned to AT&T, it, unlike the BOCs, could not recover them and likely would have no alternative but to write them off as a loss. Therefore, to assign these costs to AT&T would be inconsistent with established regulatory policy and unfair to AT&T's investors and creditors.[21]

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[20] California contends (Cal. J.S. 13) that "the BOCs in California and New York had already separated all the various elements of Account 232 and that other states would not find it difficult to do the same." The Department concluded, however, that the procedures used in these states could not necessarily be applied in other states and an attempt to segregate Account 232 costs was not, in any event, required by the decree.

[21] Moreover, there is no indication in any statements by the parties or the district court that the assumption of this debt by AT&T was an intended result of the decree, and it would not further competition in any way.

2. Wiring that connects two pieces of customer premises equipment is referred to as "complex intrasystem wiring." It, like station handling costs, is included in asset Account 232. Contrary to California's contentions (Cal. J.S. 14), this wiring is not CPE, nor is it "related to" the provision of CPE within the meaning of the decree. Thus, assignment of this portion of Account 232 to the BOCs also was proper.

California's contention (Cal. J.S. 14) that the decree's definition of CPE "clearly embraces complex inside wiring" is based on a reading of the decree language that fails to take into account the intention of the parties as evidenced by their statements to the district court. The decree defines CPE as "equipment employed on the premises of a person (other than a carrier) to originate, route, or terminate telecommunications" (J.S. App. 177). The government's February 1982 Competitive Impact Statement, filed with the court to explain the meaning and intended effect of the decree, stated (47 Fed. Reg. 7180) that the decree's "structural separation of competitive and noncompetitive markets is consistent with recent regulatory decisions," and specifically cited (*id.* at 7180 n.31) the FCC's *Computer II* decisions, in which the FCC excluded inside wiring (both simple and complex) from the category of CPE.[22]

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[22] See, *e.g.*, *In re Amendment of Section 64.702 of the Commission's Rules & Regulations (Second Computer Inquiry)*, 84 F.C.C. 2d 50, 61 n.10 (1980). Although the FCC currently is considering the deregulation of inside wiring in two proceedings (*Modifications to the Uniform System of Accounts*, 47 Fed. Reg. 44770 (1982); *In re Deregulation of Customer Premises Inside Wiring*, 86 F.C.C. 2d 885 (1981)), it has not classified this wiring as CPE. Moreover, for purposes of construing the decree, subsequent regulatory definitions of CPE are of limited relevance. Rather, the district court properly looked to the FCC's treatment of CPE at the time of the parties' reference to it.

In addition, when the provisions of the plan assigning complex inside wiring to the BOCs were challenged in the district court, the parties emphasized that they intended to follow the FCC's definition of CPE (U.S. Resp. 87; AT&T Resp. 157-158[23]). They added that, in defining CPE to include equipment used to "route" calls, they did not intend to include inside wire (U.S. Resp. 87-88; AT&T Resp. 157-158). Rather, they understood equipment used to "route" telecommunications to refer to equipment that performs a switching function, such as a private branch exchange. Although inside wiring transmits telecommunications, it is not "equipment" and does not "route" calls within the parties' understanding of those terms (U.S. Resp. 88; AT&T Resp. 156-157). The district court, having considered these factors, properly concluded that assignment of inside wiring to the BOCs is consistent with the decree's definition of CPE (J.S. App. 344).

California's argument that, even if inside wiring is not CPE, it should nevertheless be assigned to AT&T because it is "related to" the provision of CPE (Cal. J.S. 14) expands the term "related to" beyond the intent of the parties and ignores the underlying division of assets effected by the decree itself. As the parties explained to the district court (U.S. Resp. 87 n.*; AT&T Resp. 157 n.*), assets "relating to" CPE include separate ancillary assets (*e.g.*, motor vehicles, tools and other work equipment) that are associated with the provision of CPE, but do not include all assets that are "connected to" CPE. Indeed, were California's "connected to" interpretation correct, the wires from customers' premises to the BOCs' central offices also would be "related to" CPE and assigned to AT&T—a

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[23] "AT&T Resp." refers to AT&T Response to Objections to Its Proposed Plan of Reorganization, filed in the district court on March 14, 1983.

result clearly at odds with the provisions and principles of the decree.

Despite California's submission (Cal. J.S. 15), there is no inconsistency between the assignment of complex inside wiring to the BOCs and the fundamental competitive principles underlying the decree.[24] To the contrary, as the district court expressly concluded in rejecting arguments that portions of Account 232 should be assigned to AT&T (J.S. App. 344) (footnote omitted):

> In-place wiring, which is a principal item in Account 232, is as much a "bottle-neck" as are the subscriber access lines. To assign such wiring to AT&T would be to insert AT&T-controlled facilities between the Operating Companies and the subscribers, and such an assignment would thus be entirely inconsistent with the basic purposes of the decree.

Because the assignment of complex inside wiring to the BOCs furthers the decree's competitive objectives, this aspect of the plan was not only approved by the Department of Justice, but was strongly endorsed by the North American Telephone Association, an associa-

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[24] California also argues (Cal. J.S. 15) that it is unfair to local ratepayers to assign inside wiring to the BOCs because "investment in complex intrasystem wiring is now being recovered in part through equipment rates to business customers," who should continue to pay for it "as part of the complex CPE rate" that will be paid to AT&T by users of its CPE. As the government and AT&T explained to the district court, however, it is not clear to what extent the inside wiring investment in Account 232 is currently recovered through rates for embedded CPE; in many jurisdictions the rates for embedded CPE do not recover any portion of the investment in inside wiring or any other component of Account 232 (U.S. Resp. 89-90; AT&T Resp. 162-163). Moreover, after divestiture the BOCs will continue to have available a number of revenue sources for the recovery of these amounts, and there is nothing in the decree that precludes the BOCs from recovering amounts contained in Account 232 in the form of customer-specific wiring charges. *Ibid.*

tion of CPE manufacturers and suppliers that compete with AT&T. Initial Comments of North American Telephone Association at 21-22. The Kansas regulatory commission also specifically supported it (Comments of Kansas Corporation Commission at 2), and only California has challenged it on appeal.

C. The Plan's Allocation of Debt Is Consistent With the Decree

Under the plan, Pacific Telephone's embedded cost of funded debt will be approximately 9.5% (AT&T Mot. to Aff. 21, 24). The next highest embedded cost of funded debt for a BOC is Southwestern Bell's 9.4% (*id.* at 22). The Bell system average embedded cost of funded debt is approximately 8.8% (*id.* at 25 n.23). California claims (Cal. J.S. 18-20) that the plan's allocation of debt to Pacific Telephone violates the decree's requirement that "the quality of the [BOCs'] debt [at the time of divestiture] shall be representative of the average terms and conditions of the consolidated debt held by AT&T, its affiliates and the BOCs at that time" (J.S. App. 184-185).

The next sentence of the decree, however, which California conspicuously fails to mention, expressly provides that "[u]pon application by a party or a BOC, the [district c]ourt may grant an exception to this requirement" (J.S. App. 185). The district court itself required the inclusion of this sentence in the decree (see *id.* at 170-172) to permit non-uniform allocation of embedded debt where "it can be shown that, with respect to a particular Operating Company, its own current debt provides a more equitable basis" (*id.* at 137 n.321). Such a showing was made in the case of Pacific Telephone, and there consequently was no abuse of discretion in the district court's approval of this aspect of the plan.[25]

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[25] California claims (Cal. J.S. 20 n.19) that the district court never granted "a formal exception to the decree." If California is suggesting that the court did not grant an exception to the

As the Department and AT&T explained to the district court (U.S. Resp. 117-122; AT&T Resp. 284-299), several factors contribute to Pacific's higher embedded cost of debt. First, the embedded cost of debt for the three high growth "Sun Belt" regional operating companies (Southern-South Central Bell, Southwestern Bell, and Pacific Telephone) is higher than that for BOCs serving other regions. This difference reflects the fact that the BOCs that serve high growth areas have had more frequent and more recent occasion to go to the debt market to meet their service demands. If each of the seven regional companies were required to be divested with the average cost of debt of the Bell System as a whole, the three Sun Belt regions with their higher embedded cost of debt would, in effect, receive a subsidy from the four regional companies that serve more slowly growing areas. Such subsidies, the parties explained (U.S. Resp. 119; AT&T Resp. 278-281), and the court agreed (J.S. App. 222 n. 64), would have been unfair to the lower growth companies and to their subscribers.

Second, Pacific Telephone's embedded cost of debt is higher than the costs of even other high growth BOCs because its financial condition, as measured by its rate of return, stock price, financial ratios, bond ratings,

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equal debt quality requirement, its argument lacks merit because the court substantively, if not "formally," granted such an exception. The Department and AT&T both requested that the court grant whatever exceptions to the equal debt quality standard were necessary for approval of the plan (U.S. Resp. 119, 122; AT&T Resp. 298), and the court, which expressly referred to Pacific's unique circumstances (J.S. App. 222 n.64), must be understood to have granted whatever exception to that standard was necessary to support its approval of the debt allocation provisions of the plan. If, on the other hand, California is suggesting that some exception to the *decree* itself is necessary, its argument fails because the decree *does* permit the non-uniform allocation of debt approved by the court.

and the views of analysts and investors, had steadily deteriorated between 1973 and 1980 (see J.S. App. 137 n.320; AT&T Resp. 285-299; AT&T Mot. to Aff. 5 n.3, 23-24). Indeed, the modified consent decree explicitly recognizes Pacific Telephone's unique financial situation, and accordingly provides that Pacific Telephone is to be divested with approximately 50% instead of approximately 45% debt, as in the case of the other BOCs (J.S. App. 184; see J.S. App. 137 & n.320).

Moreover, there is nothing in the modified consent decree or any related proceeding to support California's contention (Cal. J.S. 19) that, because the decree expressly provided Pacific Telephone with a less advantageous debt ratio than the other BOCs, the decree's provision for an exception to the equal debt quality standard could not also be applied to Pacific. On the contrary, as a matter of economics, the decree's debt ratio provision supports application of the equal debt quality exception to Pacific. It is the combination of Pacific's higher debt ratio and its lower bond rating that accounts for the difference between Pacific's embedded debt costs and those of the other Sun Belt companies.[26] In these circumstances, a reallocation of embedded debt to give Pacific the systemwide average cost would unfairly impose on other BOC ratepayers or AT&T stockholders costs attributable to factors unique to California. As the district court recognized: "The debt equalization scheme which is proposed by California would inappropriately result in inter-regional subsidies * * *" (J.S. App. 222 n.64).[27]

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[26] In response to objections to this aspect of the plan, AT&T suggested to the district court (AT&T Resp. 285, 297) that the bulk of the difference between Pacific Telephone's embedded cost of debt and the lower debt costs of the other Sun Belt companies is attributable to the downgrading of Pacific's debt between 1973 and 1980 from an "AAA" to an "A−" rating.

[27] Contrary to California's contention (Cal. J.S. 19), there is

Finally, California's argument ignores the fact that, as the district court noted, "neither the decree nor the plan of reorganization adversely affects Pacific's financial condition; if anything, they improved it" (*ibid.*). Indeed, the plan, which was amended in response to the comments of Pacific's management and now has its support, has resulted in significant improvement in Pacific's financial condition. As originally proposed, the plan would have left Pacific with a debt ratio of 50%[28] and an embedded cost of funded debt of 9.7%-9.9% (see AT&T Resp. 295). Under the plan as approved by the district court, however, Pacific is projected to be divested on January 1, 1984, with a 46.5% debt ratio (significantly better than the 50% provided for by the decree) and an embedded cost of funded debt of approximately 9.5% (AT&T Mot. to Aff. 21, 24-25).[29] As a result of the advantages anticipated from the proposed divestiture, Standard & Poor's, on March 28, 1983, raised Pacific's debt rating from A− to A+ (see AT&T Mot. to Aff. 24 n. 22). Thus, as Pacific's management agrees, its financial condition is fully adequate to allow its post-divestiture viability. The district court correctly exercised its discretion in concluding that the embedded debt allocation provisions of the plan are consistent with the provisions and principles of the decree.

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no inconsistency between this allocation and the allocation of contingent antitrust liabilities. As the court noted (J.S. App. 214-215), there were no substantive differences among the BOCs that compelled differential allocation of the contingent antitrust liabilities.

[28] The 50% debt ratio itself represented a reduction from Pacific's 1981 debt ratio of 57%. See AT&T Resp. 267.

[29] See also Amendment to Plan of Reorganization No. 36 (Topic: Long-Term Debt) (April 7, 1983); Second supplemental statement of Donald E. Guinn filed in the district court on April 7, 1983.

CONCLUSION

The Court should accept the appeals and affirm the judgment of the district court.

Respectfully submitted.

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